

Motor Vehicle Registration Abuse

OFFICE FOR PROGRAM REVIEW & INVESTIGATIONS

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LEGISLATIVE RESEARCH COMMISSION

Frankfort, Kentucky

Committee for Program Review and Investigations

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Foreword

At the July 9, 1998 meeting of the Committee, a preliminary study of motor vehicle registration abuse was authorized. This report was adopted by the Committee on December 10, 1998, and submitted to the Legislative Research Commission.

This report is the result of dedicated time and effort by the Program Review staff. Our appreciation is extended to the Commissioner of the Department of Property Valuation and the staff of the Division of State Valuation within the Revenue Cabinet, and all other persons interviewed for this study.

Peggy Hyland
Acting Director

Frankfort, KY
January, 1999

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MEMORANDUM

TO: The Honorable Paul E. Patton, Governor
The Legislative Research Commission,
Affected Agency Heads, and interested individuals

FROM: Representative Jack Coleman, Presiding Co-Chairman
Senator Joey Pendleton, Co-Chairman
Program Review and Investigations Committee

SUBJECT: Staff Report -- Motor Vehicle Registration Abuse

DATE: December 10, 1998

Attached are the final report and recommendations of a study of the problems associated with motor vehicle registration abuse within Kentucky. Motor vehicle property taxes provided approximately \$226.5 million in revenue in FY 98. Roughly 65% of this amount goes to fund school districts and other local governments.

Motor vehicle property taxes in Kentucky are collected yearly when motor vehicle registrations are renewed. Some states bordering Kentucky, however, such as Ohio and Tennessee, do not levy property taxes on motor vehicles. Kentucky residents living near the border with these states may be tempted to cross the border and improperly register their vehicles in these neighboring states to avoid paying Kentucky property taxes on their vehicles. Both state and local officials in Kentucky have indicated that this is a problem in some areas of the state. We estimate that over \$17 million dollars is being lost each year due to motor vehicle registration abuse.

The Kentucky State Police and the Revenue Cabinet have undertaken a joint project, called Operation Border Crossing, as an effort to detect improperly registered vehicles. Local police and sheriffs, however, may have better visibility over local communities and may be better positioned to detect members of their community driving with an out-of-state registration on their vehicle. This report recommends that the Kentucky State Police and the Revenue Cabinet

continue their joint enforcement efforts. Similarly, we also recommend that the Kentucky Transportation Cabinet's Division of Vehicle Enforcement continue their efforts. We also recommend, however, that the General Assembly consider providing an incentive to local law enforcement officials by mandating that any fines or penalties assessed against motor vehicle registration abusers be shared with the organization responsible for identifying the registration abuse, thus supplementing their budgets. If you have questions or wish to request additional copies of this report, please contact Joseph Fiala, Ph.D., LRC Assistant Director, Office for Program Review and Investigations.

Revenue Lost Through Motor Vehicle Registration Abuse

Over \$17 million per year may be lost to Kentucky state and local governments as a result of the evasion of motor vehicle property and usage taxes by individuals who abuse or circumvent the state's motor vehicle registration system. The Revenue Cabinet, through its Freddie Freeroader program, has taken steps to identify abusers, but problems have continued. Recently the Revenue Cabinet's efforts have been assisted by the Kentucky State Police in their Operation Border Crossing. While all states experience some motor vehicle registration avoidance, we believe that Kentucky's problem with motor vehicle registration abuse may be greater than average. This difference, in large part, may be attributed to the disparity between Kentucky's motor vehicle registration costs and the cost to register vehicles in neighboring states. Other potential problems associated with motor vehicle and boat registration are identified in Appendix I.

Vehicle Taxes Support State and Local Governments

When Kentucky citizens go through the annual process of registering their motor vehicles, they pay not only their registration fee, but also the yearly tangible property tax on the vehicle. Additionally, the first time an owner registers a vehicle the state assesses usage tax on the sale price of the vehicle. The revenue generated from these motor vehicle taxes goes to a variety of recipients:

- Motor vehicle property tax is set at a state rate of 45 cents per \$100 of fair cash value, plus local rates.
 - Approximately 65% of the property tax collected goes to county and local governments to fund schools and a variety of other special taxing jurisdictions.
 - The remaining 35% of motor vehicle property taxes goes to the state's general fund.
- All proceeds from the motor vehicle usage tax are earmarked for the state's Road Fund.

Although the majority of citizens within the Commonwealth pay their fair share of these taxes, there are indications that a number of citizens avoid paying motor vehicle property and usage tax through a variety of means. Some individuals license their cars in states that have no, or very low, property taxes on motor vehicles; others abuse the use of temporary tags, or simply fail to renew the registration on their vehicles. As a result, Kentucky is losing income that should go for the repair of the state's roadways, fund local schools, and provide other services.

The number of individuals cheating on the motor vehicle taxes (nicknamed Freddie Freeroaders, because they drive on Kentucky highways free while others pay the taxes necessary for the maintenance of the roads) is difficult to determine; consequently, the amount of revenue lost to these “Freeroaders” is also difficult to determine. The state currently taxes over 3 million vehicles a year, and collect \$244,633,268 in property taxes and \$317,000,000 in usage taxes during 1997. The table below identifies the recipients of FY 98 actual and projected personal property tax revenue from motor vehicles and boats.

Chart 1
Motor Vehicle and Boat Personal Actual and Projected Property Tax Revenue
By Unit of Government, FY 1998

State General Fund	School Districts	Counties and Special Districts	Cities	Total
\$81,500,000	\$76,700,000	\$45,100,000	\$23,200,000	\$226,500,000

Source: Compiled by PR&I staff from data provided by the Revenue Cabinet.

Kentucky Losing Over \$17 Million in Revenue

We estimate that over \$17 million in revenue may be lost to the state and local governments due to motor vehicle registration abuse. This estimate was based on statistics from a national study conducted by the Council of State Governments (CSG), as well as data provided by Operation Border Crossing. Operation Border Crossing is a statewide effort to detect and bill those Kentuckians with improperly licensed vehicles. Beginning in November 1997, State Police forwarded copies of citations written for registration violation to the Revenue Cabinet, where Revenue Cabinet officials have attempted to identify and bill those with lapsed or improper vehicle registrations. We reviewed Operation Border Crossing information, in an effort to derive an estimate of motor vehicle usage tax abuse.

CSG identified studies conducted by states across the nation, and found losses in registration and licensing fees ranging up to 7 percent. Additionally, the CSG study surveyed principal revenue administrators for states across the nation and found that, on average, these state officials estimated “a 4.95 percent gain in motor vehicle registration and licensing taxes from the elimination of evasion.”¹ Kentucky may be expected to have a higher than average level of

¹ “Road Fund Tax Evasion: A State Perspective”, The Council of State Governments and The Council of Governors’ Policy Advisors, 1996, p.55

evasion , since several border states do not levy property tax on motor vehicles, or do not require proof of insurance at the time of motor vehicle registration.

In an effort to present a conservative estimate of the potential range of cost to the Commonwealth and local governments, Program Review and Investigations Committee staff developed estimates based upon an assumed 4 percent and 7 percent increase in motor vehicle property taxes. Additionally, data provided by Operation Border Crossing from November 1997 through August 1998 revealed that roughly 70% of all vehicles cited for improper registration also owed state usage tax. The forgone usage tax was also included in the calculation (See Chart 2 below).

Chart 2
Estimate of Motor Vehicle Property Tax Avoidance

Calculation Factor	Assuming 4% Increase in Vehicle Registration Taxes	Assuming 7% Increase in Vehicle Registration Taxes
[FY 97 Motor Vehicle State Property Tax Receipts: \$77,415,810]		
Increase in State Receipts Based on Respective Rates	\$3,096,632	\$5,419,107
Including local share of motor vehicle property tax (Approximately 65% of total motor vehicle property tax collected goes to local governments and special taxing districts) FY 97 Motor Vehicle Property Tax Loss	\$8,847,520	\$15,483,163
FY 97 State Motor Vehicle Usage Tax	\$304,868,491	\$304,868,491
Estimated Usage Tax Loss*	\$8,536,318	\$14,938,556
Total Revenue Forgone (Property Tax Loss + Usage Tax Loss)	\$17,383,838	\$30,421,719

Source: Program Review and Investigations Staff.

*Usage tax loss calculation was based upon results of Operation Border Crossing. These results indicate that 70% of those with improper registrations also owed state usage tax on the vehicle. Calculating 70% of the two estimates, we derived an estimated 2.8% and 4.9% usage tax evasion respectively.

Lower Taxes in Neighbor States Contribute to the Problem

In large part, Kentucky's vehicle registration avoidance problem stems from the difference between the cost associated with registering a motor vehicle in Kentucky and the amount charged by some of Kentucky's bordering states. Appendix III illustrates how Kentucky's motor vehicle property taxes and fuel taxes compare with those of neighboring states and Florida. Florida was because anecdotal evidence suggests that some Kentucky residents have registered their motor vehicles there to avoid Kentucky taxes.

All states may expect to face some level of tax avoidance. CSG's study anticipated an average 4.95 percent gain in motor vehicle registration and licensing taxes if evasion were eliminated. Kentucky, however, may expect to have a higher than average amount of evasion, because:

1. Neither Tennessee nor Ohio charges motor vehicle property taxes; therefore, citizens of Kentucky living in counties near Tennessee or Ohio may be tempted to cross the border to register their vehicles.
2. Tennessee does not require proof of insurance at the time of vehicle registration. As the CSG study noted, "States that require proof of insurance before an automobile may be registered may also face higher rates of evasion of registration." This may serve as a double incentive for people living along the Kentucky/ Tennessee border to register their vehicles in Tennessee.

Revenue Cabinet and local government officials have confirmed this trend, observing that the ease of registering vehicles in border states tempts many Kentucky residents to evade the Commonwealth's motor vehicle property and usage taxes. Revenue Cabinet officials told us the existing laws were adequate to prohibit this practice, but they said enforcement of the existing laws was inconsistent. While the State Police have been actively involved through Operation Border Crossing, local police and county sheriffs often do not assign a high priority to motor vehicle registration abuse.

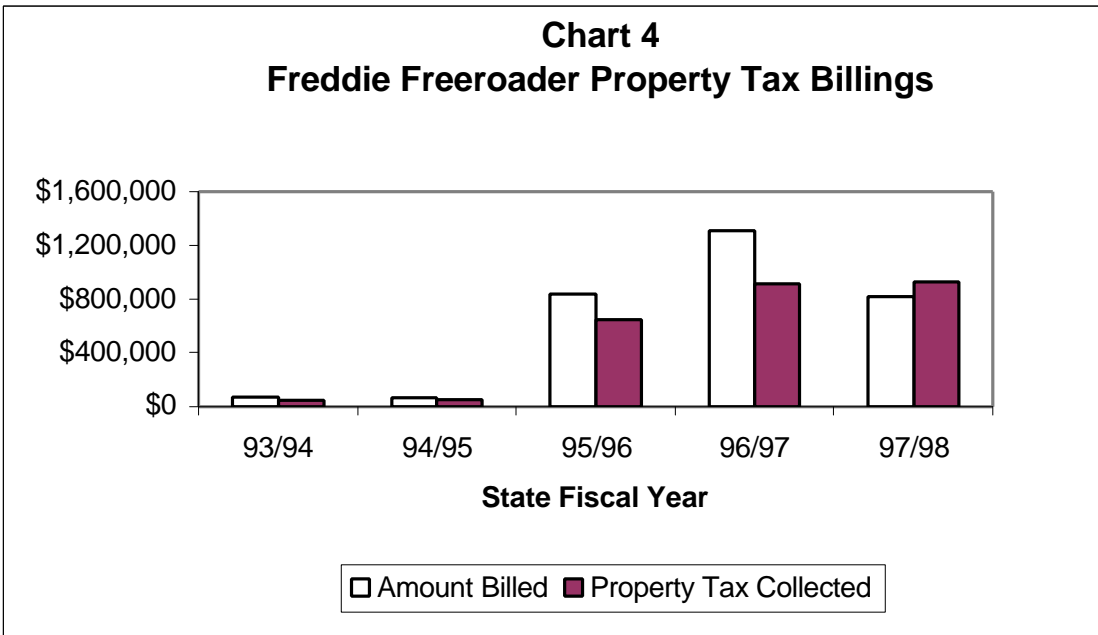
Collection Lagging Behind Billing

The Revenue Cabinet's Freddie Freeroader program began in 1986. From 1987 through 1992 Revenue sent out 28,366 bills, totaling over \$8.2 million in taxes. Billings and receipts for state fiscal years 93/94 through 97/98 are detailed below.

Chart 3
Freddie Freeroader Property Tax Statistics
FY94-FY 98

State Fiscal Year	Property Tax Bills	Vehicle Assessed Values	Tax Amount Billed	Average Amount Billed	Property Tax Collected	Percent Collected
93/94	810	\$5,371,026	\$73,124	\$90.28	\$47,053	64.35%
94/95	480	\$4,840,753	\$65,412	\$136.28	\$48,926	74.80%
95/96	4,577	\$63,444,602	\$836,320	\$182.72	\$644,681	77.09%
96/97	6,062	\$103,657,661	\$1,307,679	\$215.72	\$915,765	70.03%
97/98	4,497	\$63,932,796	\$817,783	\$181.85	\$929,301	113.64%

Source: Based on data provided by Revenue Cabinet officials.

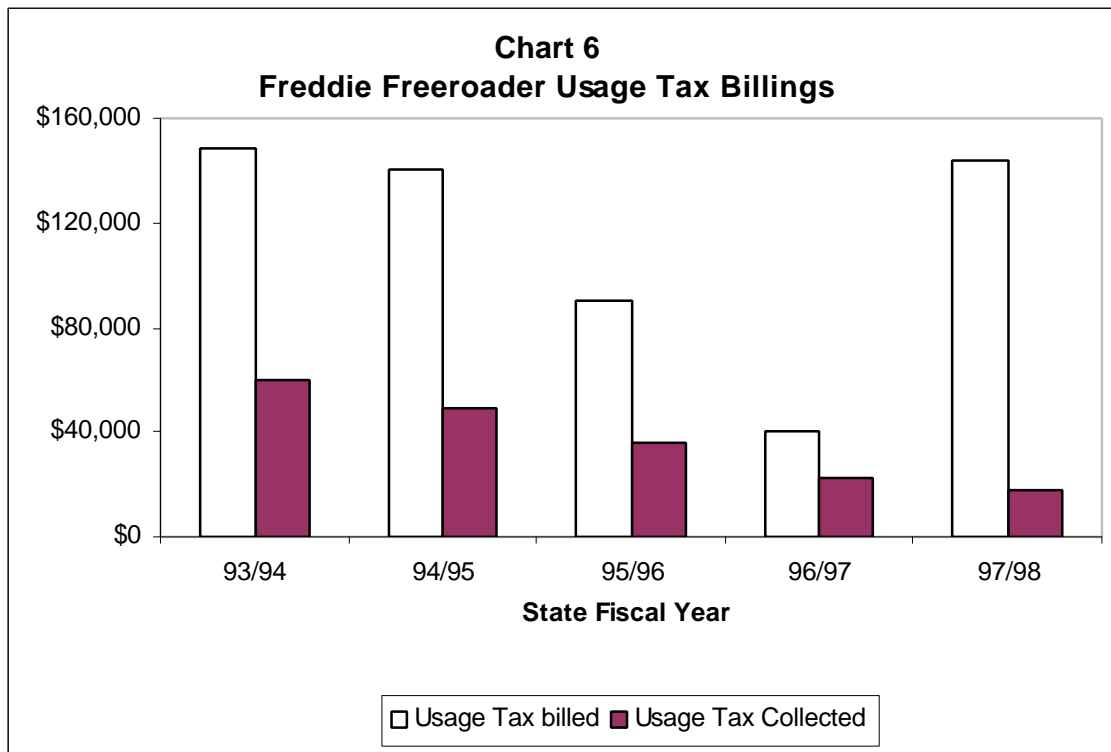


Source: Based on data provided by Revenue Cabinet officials.

Chart 5
Freddie Freeroader Motor Vehicle Usage Tax Statistics
FY 94-FY 98

State Fiscal Year	MV Usage Tax Bills	Average Assessed Value	Tax Amount Billed	Average Amount Billed	Usage Tax Collected	Percent Collected
93/94	315	\$7,834.25	\$148,067.00	\$470.05	\$60,130.00	40.61%
94/95	256	\$9,114.23	\$139,995.00	\$546.86	\$49,012.00	35.01%
95/96	98	\$15,329.04	\$90,135.00	\$919.74	\$35,787.00	39.70%
96/97	74	\$9,075.64	\$40,296.00	\$544.54	\$22,118.00	54.89%
97/98	146	\$16,377.87	\$143,470.00	\$982.67	\$17,864.00	12.45%

Source: Based on data provided by Revenue Cabinet officials.



Source: Based on data provided by Revenue Cabinet officials.

Local Enforcement May Be More Effective Than State Enforcement

While the Freddie Freeroader program and Operation Border Crossing have been productive, state police may not be in the best position to detect and apprehend motor vehicle registration violators. Local police and sheriffs have a better visibility over their respective communities, and would more likely notice local residents with out-of-state or lapsed vehicle registrations. Police, however, also have a number of other priorities. Individuals knowledgeable about the current system have told us that an incentive program, whereby fines assessed on violators could be shared with local police departments or sheriffs' offices, could enhance the priority of the program within local communities and reduce the amount of motor vehicle registration violation.

Constitutional Amendment Two

With the recent passage of Constitutional Amendment Two, the General Assembly now has the discretion to exempt motor vehicles, or other personal property, from the levy of the property tax. As noted earlier in this report, significant revenue is generated from motor vehicle and boat property taxes for school districts, as well as cities, counties and special districts. Other tangible property taxes also contribute significant amounts to these political entities. Table 7, below, indicates the contribution of tangible and intangible property tax to different levels of government within the Commonwealth.

Chart 7

FY 98 Actual and Projected Collections

	Motor Vehicles and Boats Property Tax	Other Tangible Property Tax	Intangible Property Tax
State General Fund	\$81,500,000	\$91,000,000	\$27,500,000
School Districts	\$76,700,000	\$102,200,000	
Counties and Special Districts	\$45,100,000	\$60,100,000	
Cities	\$23,200,000	\$31,200,000	
Total	\$226,500,000	\$284,500,000	\$27,500,000

Source: Based on data provided by Revenue Cabinet officials.

Recommendations

To promote more effective collection of motor vehicle property tax revenue owed the Commonwealth, and to promote a more equitable distribution of the property tax burden, we make the following recommendations:

1. Continue current enforcement efforts

In recognition of efforts currently underway by the Revenue Cabinet and the Kentucky State Police, we recommend the continuation of the collaborative effort between these two organizations to find and properly bill individuals with improperly registered motor vehicles. Additionally, we recommend that the Transportation Cabinet's Division of Vehicle Enforcement continue its efforts to enforce vehicle registration laws regarding passenger and commercial vehicles.

2. Provide statutory incentives for enforcement of motor vehicle registration laws

We also recommend that the General Assembly consider providing an incentive to local law enforcement officials, as well as state police, by mandating that any fines or penalties assessed against motor vehicle registration abusers be shared with the organization responsible for identifying the registration abuse. Thus, sheriffs and local police departments can supplement their budgets by proceeds from detecting motor vehicle registration abuses.

Potential Problem Areas in Collection of Motor Vehicle Property Tax

1. **Leased vehicles:** Kentucky citizens may be leasing cars from out-of-state firms, in which cases though the vehicles are located in Kentucky for the required 15-day period, Kentucky does not receive the due amount of property taxes. Kentucky laws require the registration of vehicles within 15 days of purchase or transport into the state for use. (See KRS 186A.095 and 186A.120 Sections 4 and 5.)
2. **Fleet operators of U-Drive-It programs:** (Defined by KRS 281.014 as, "any person who leases or rents a motor vehicle for consideration to be used for the transportation of persons or property, but for which no driver is furnished, and the use of which motor vehicle is not for the transportation of persons or property for hire by the lessee or rentee.") This has been noted as a potential problem, particularly at the Northern Kentucky/Cincinnati Airport. Such companies as AVIS, Hertz and Budget operate in a large number of states and may license their vehicles in any state they operate in. The allocation program operated by the U-Drive-It division of the Transportation Cabinet determines how many vehicles each company should register in Kentucky, according to their annual revenue. While companies are required to register their vehicles, the timing of registration, and location of registration is at the company's discretion. The opportunity exists for these companies to register their vehicles at one point in the year, then cancel the registration and move the vehicles out of state before January 1, when property taxes are assessed. Vehicles could then be moved back into the state after property taxes are assessed, thereby avoiding Kentucky motor vehicle property tax entirely. These companies would still be required to pay their 6% U-Drive-It fee, based upon rental receipts.
3. **Boats:** As with other vehicles, boats purchased or transported into the state should be registered within 15 days. However, property tax is not assessed until January 1 of each year. Out-of-state boaters may be leaving their boats at Kentucky docks throughout the summer, but then transporting them to their home states during the Winter, thus removing the boats before a property tax assessment can be made. Some out-of-state boaters may be avoiding motor vehicle property tax because of the current method of property tax assessment.

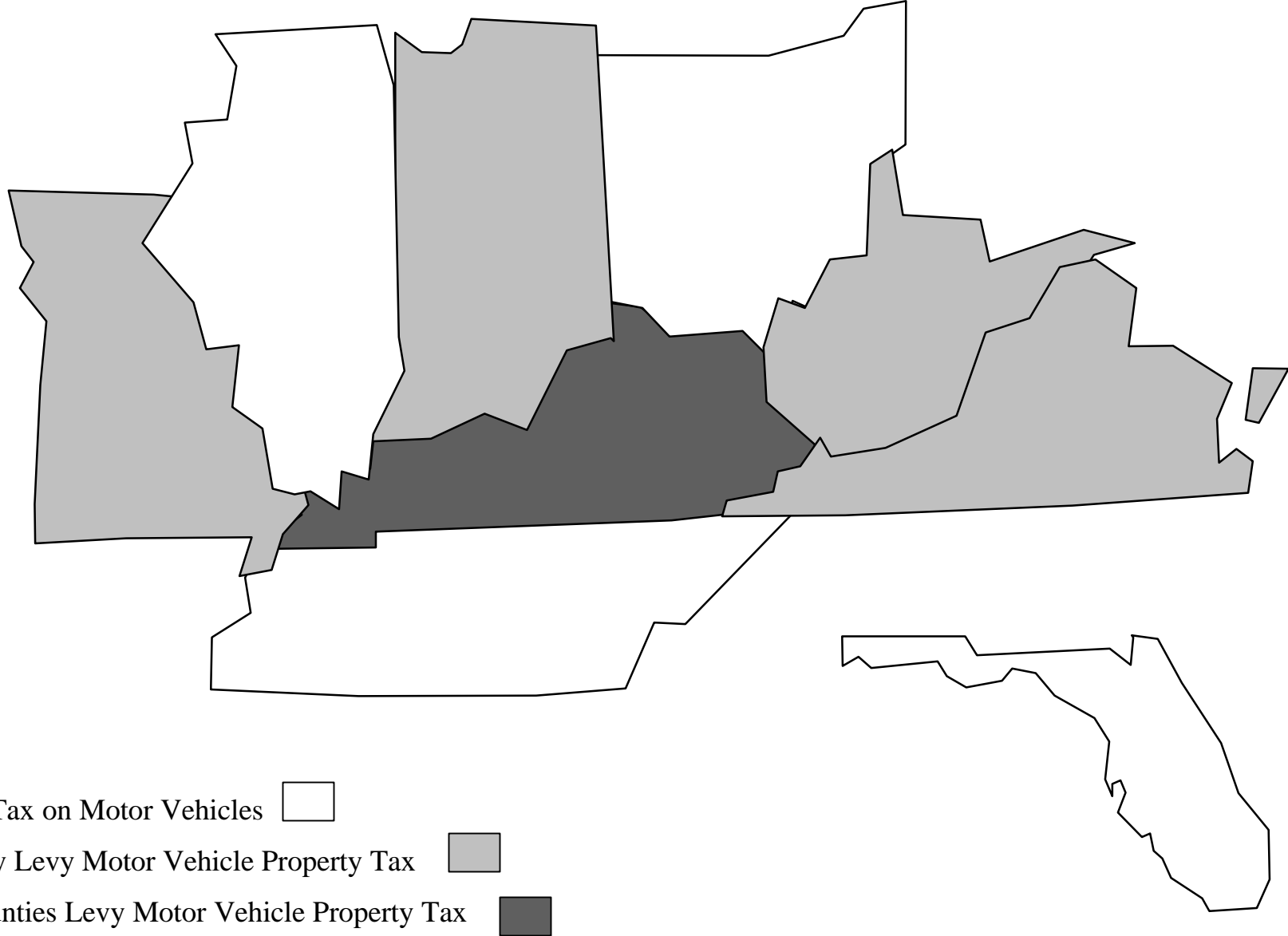
Freddie Freeroader Program Chronology

Date	
1976	Creation of the Automated Vehicle Information System (AVIS), for the automated registration and titling of motor vehicles.
1984	Motor Vehicle property tax collection efforts moved from the county sheriff to the county clerk. Payment of motor vehicle property tax is required to register vehicles. The automated system and the requirement that motor vehicle property tax be paid before receiving vehicle registration dramatically improves collection of motor vehicle property tax.
1985	January 1, 1985, first assessment of Motor Vehicle Property Tax.
Oct. 1985	Revenue Cabinet begins designing the Freddie Freeroader program.
1986	Revenue Cabinet begins gradual implementation of Freddie Freeroader program with one full-time person.
Dec. 1986	\$276,354 payment from GMAC to cover cars leased by Kentucky citizens for which no property taxes were paid during 1984, 1985, and 1986.
Jan. 1988	Freddie Freeroader program reaches maximum size with five full-time people.
1988	Motor Vehicle usage tax enforcement included in Freddie Freeroader program. Toll-free anonymous tip hotline installed.
1987-1992	Program identifies approximately 26,758 vehicles, or 4459 vehicles per year, average yearly billing of \$1,888,101.
March 1993	Freddie Freeroader program transferred to Department of Property Tax, within the Revenue Cabinet. Priority of program reduced, reduced to two employees.
November 1, 1997	Kentucky State Police begin statewide implementation of a program called "Operation Border Crossing", to catch those living in Kentucky with vehicles licensed in other states.
August 1, 1998	Effective date of HB 74, which changed the motor vehicle property tax valuation procedures as well as the assessment of the usage tax. Prior to HB 74 motor vehicle property tax was based upon the average retail value of the vehicle, usually based upon the NADA guide. HB 74 changed the basis for property tax calculation to the average trade-in value of the vehicle. This bill also changed the basis of the usage tax to the actual consideration paid for the vehicle.

Motor Vehicle Property Taxes In States Surrounding Kentucky

Program Review and Investigation Committee
Staff Presentation
12/10/98

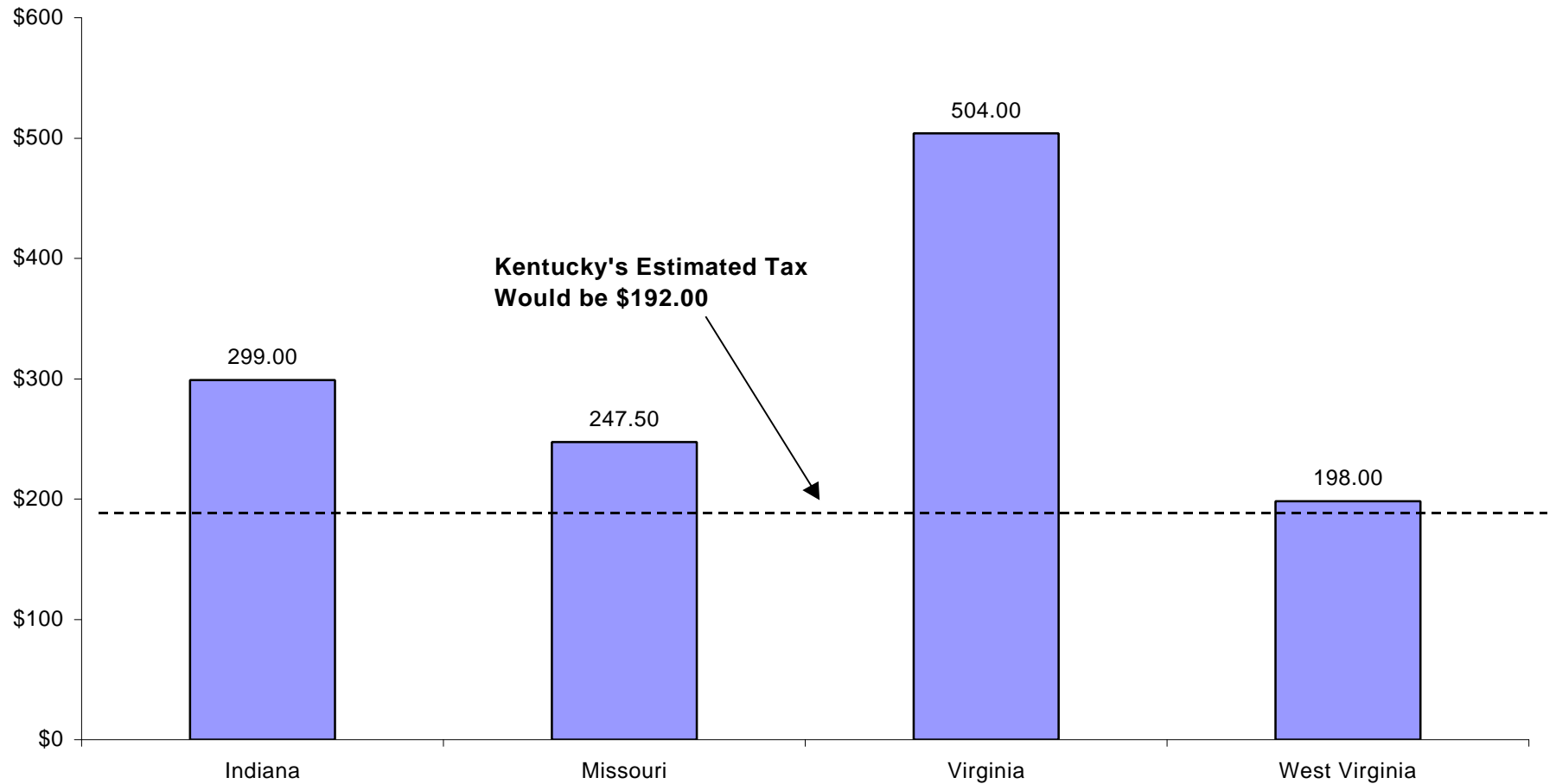
Motor Vehicle Property Tax Levy



Motor Vehicle Property Tax Rates

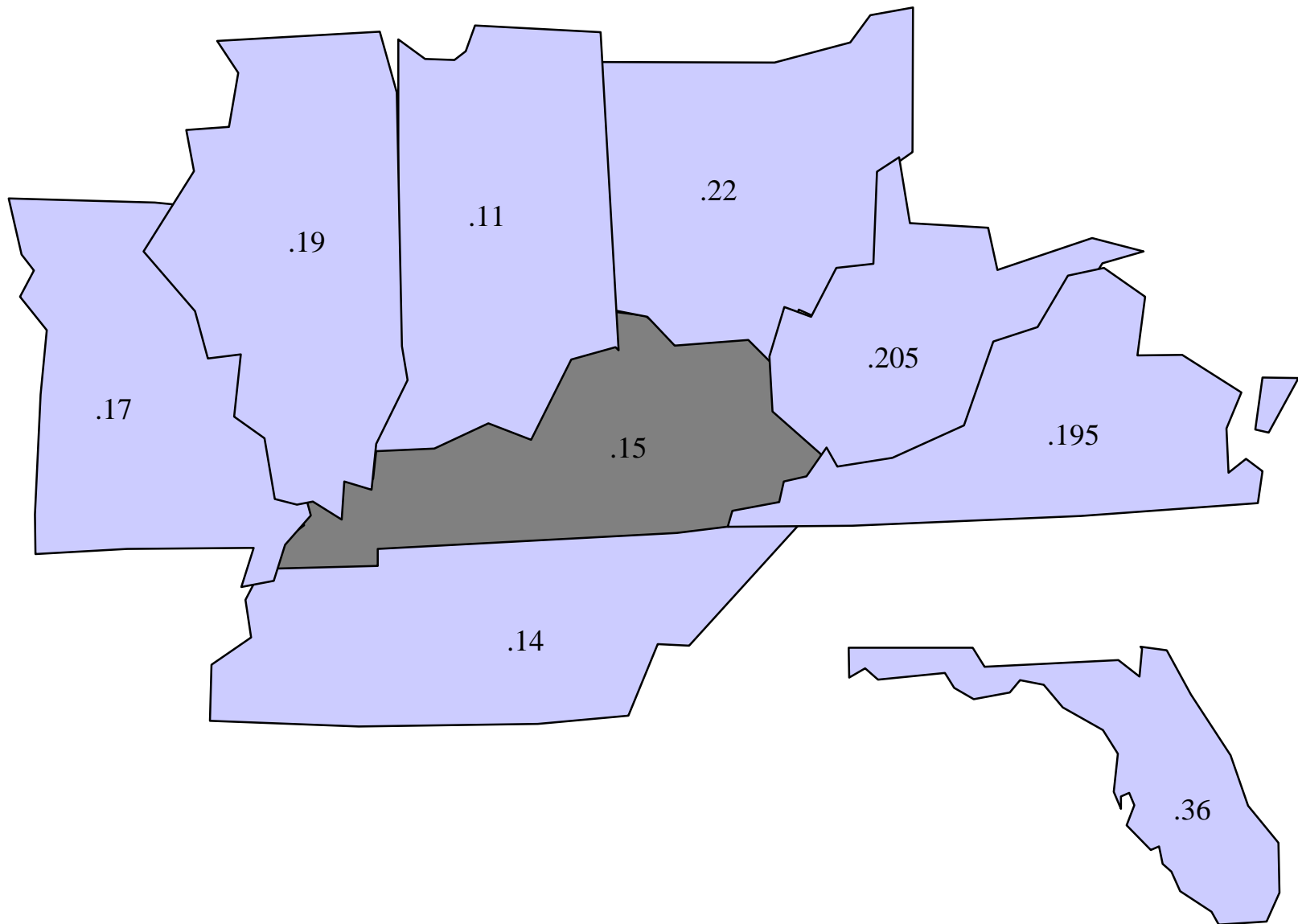
State	Tax Rate
Indiana	\$532 to \$11 per year based on MSRP and age of vehicle.
Missouri	Averages approx. 5% of 33.3% of cars' NADA value.
Virginia	County rates average \$3.36 per \$100 of assessed value. Additional city rates average \$3.61 per \$100 of assessed value. Other local taxing rates may also apply.
West Virginia	Tax Assessments are 60% of lowest NADA value. Rates average \$2.20 per \$100 outside municipalities and \$2.93 per \$100 inside municipalities.
Kentucky	Average state plus local rate equals \$1.28 per \$100 value of vehicle.

Estimated Motor Vehicle Property Tax \$15,000 Vehicle

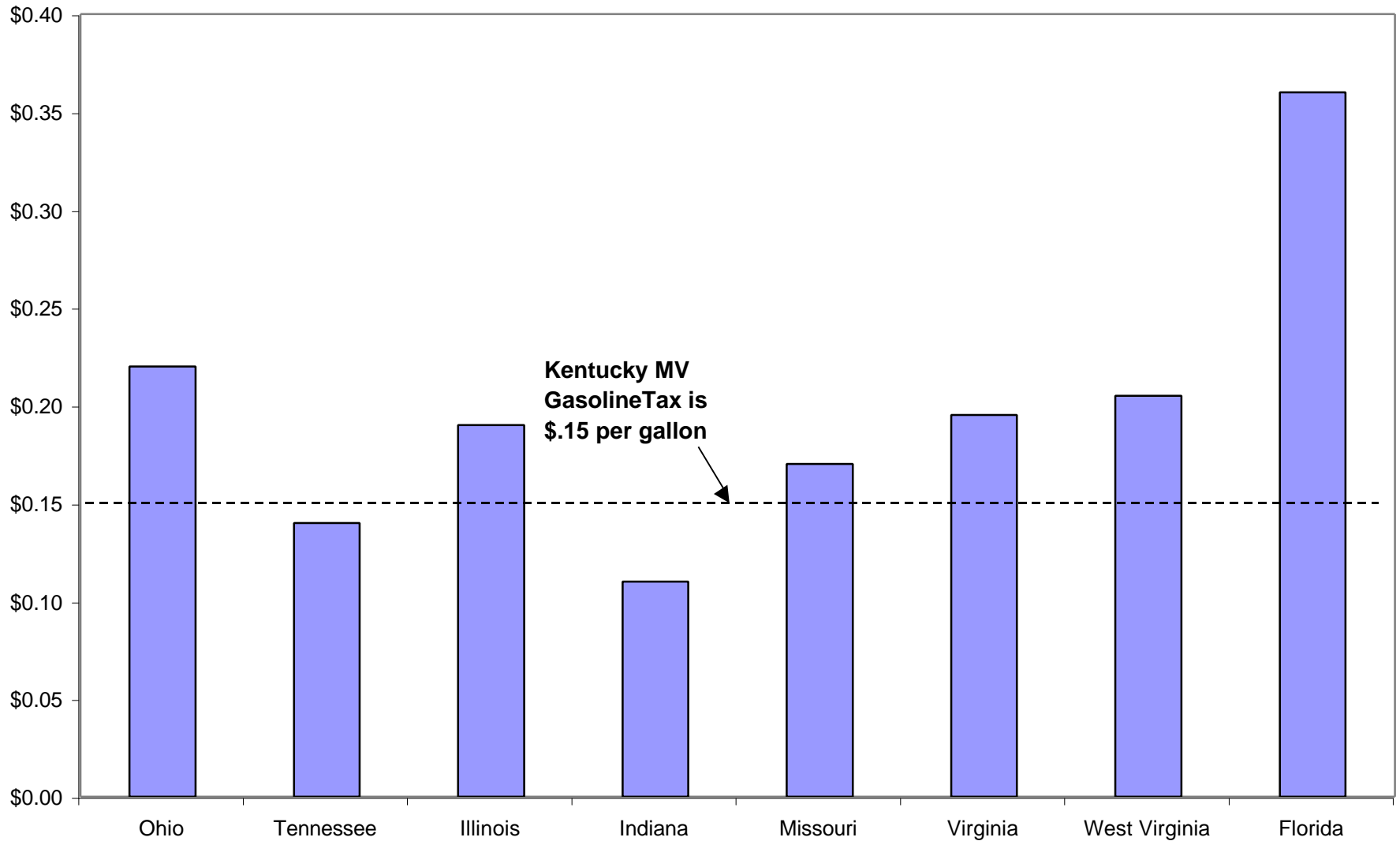


Assumes the Auto is one year old. Additionally, rates used apply to 1998 alone. Indiana's rates will be declining in coming years and Virginia will be phasing out the collection of motor vehicle property tax.

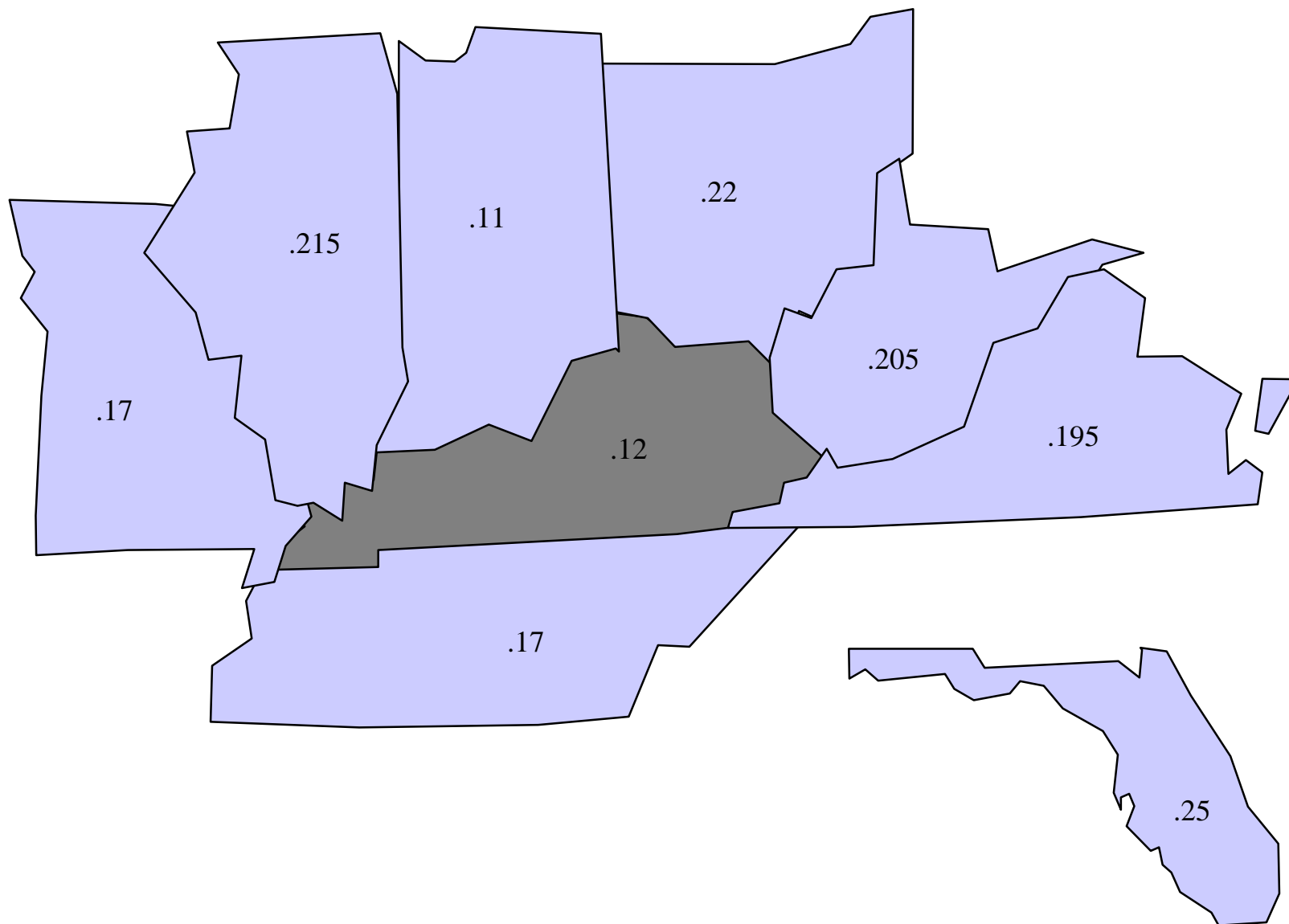
**Motor Vehicle Fuel Tax (Gasoline)
Per Gallon**



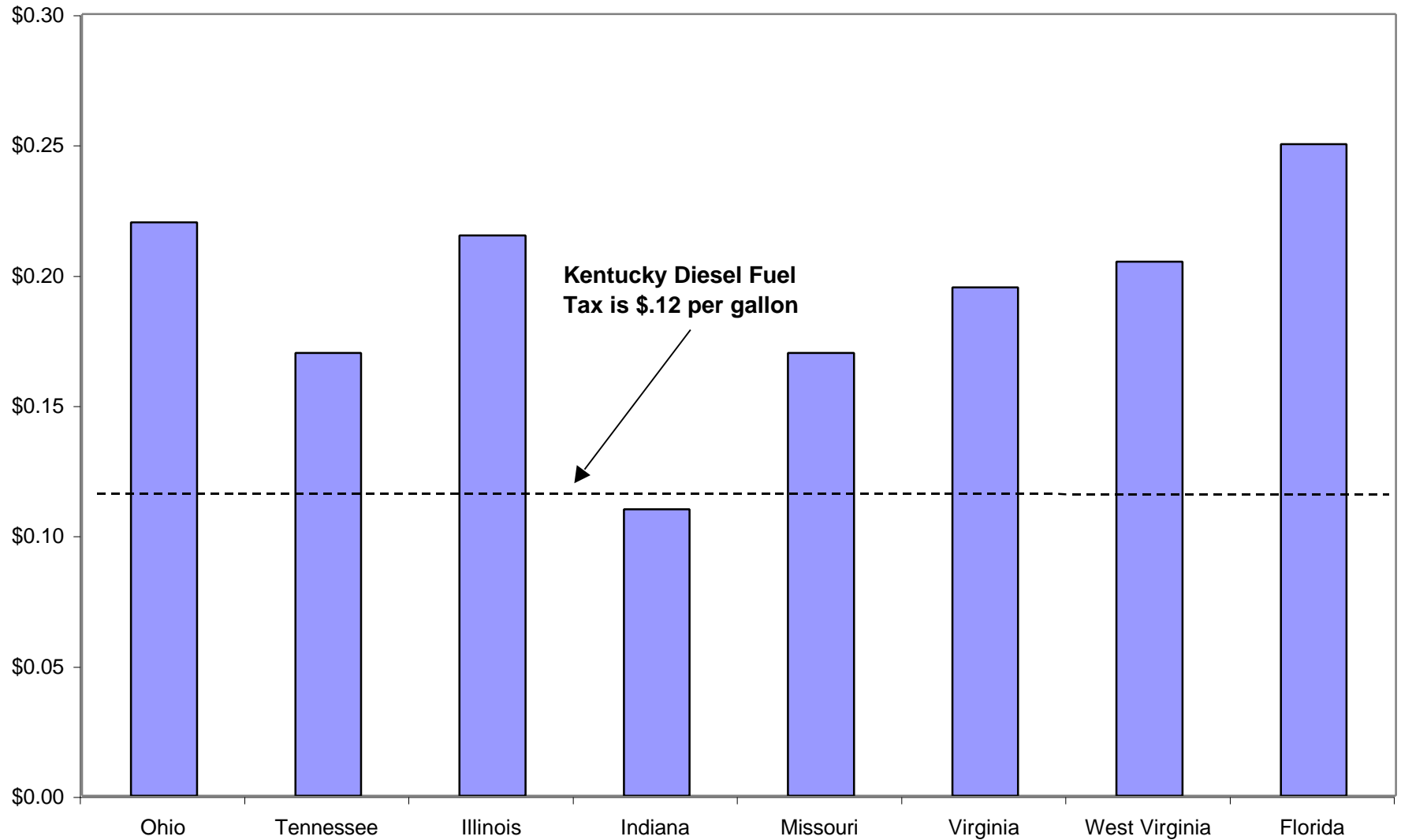
Motor Vehicle Fuel Tax (Gasoline)



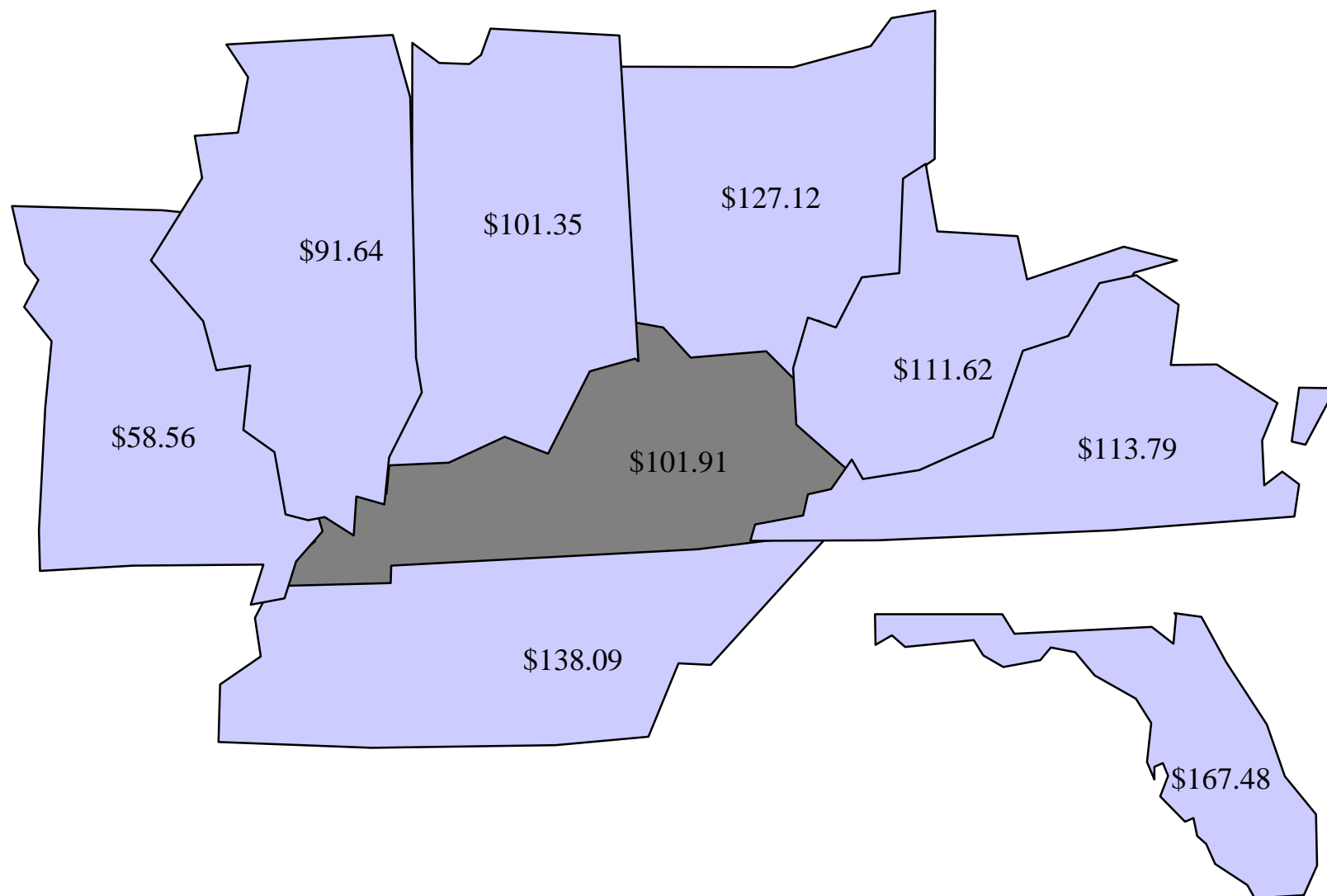
Motor Vehicle Fuel Tax (Diesel)



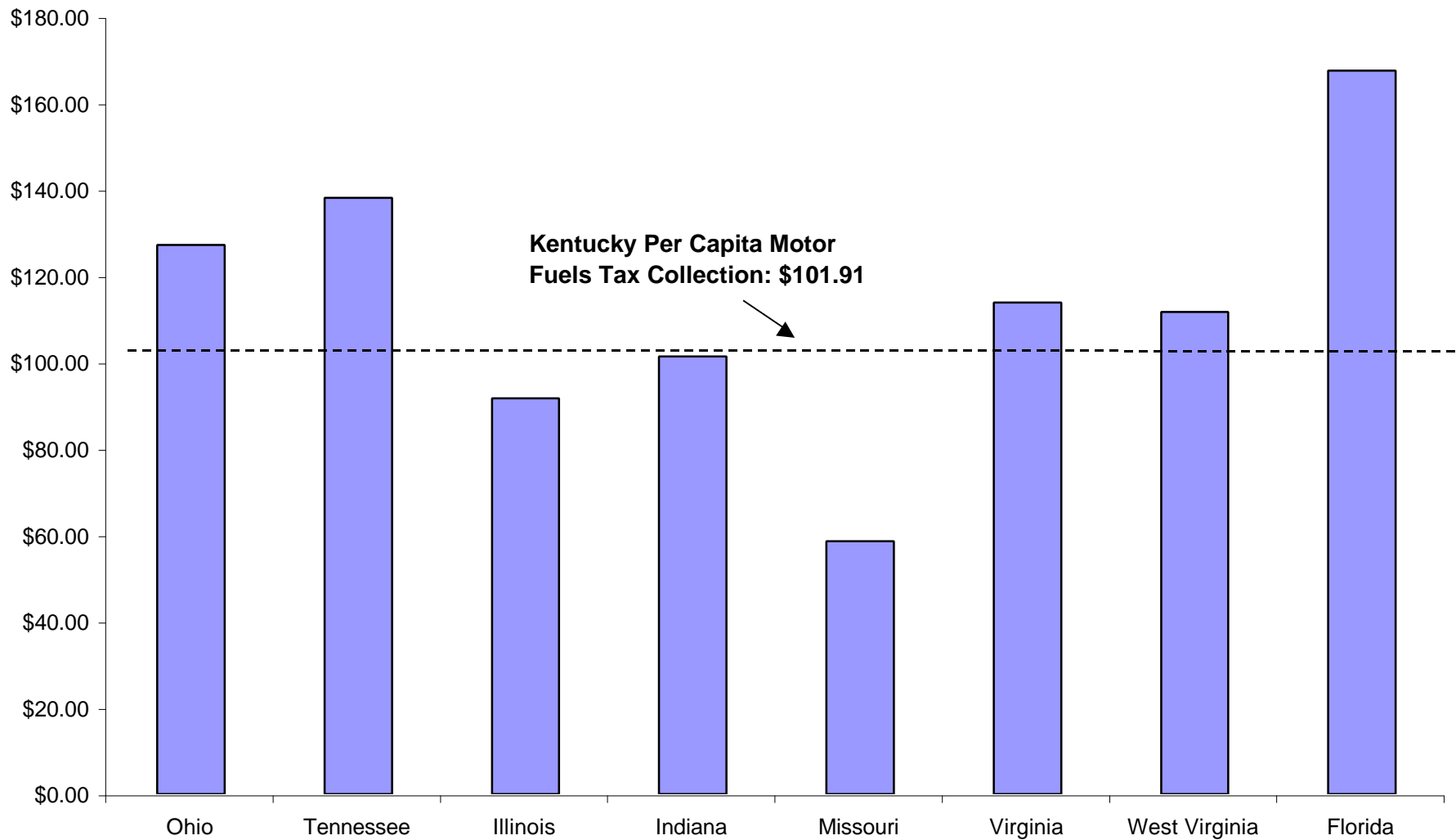
Motor Vehicle Fuel Tax (Diesel)



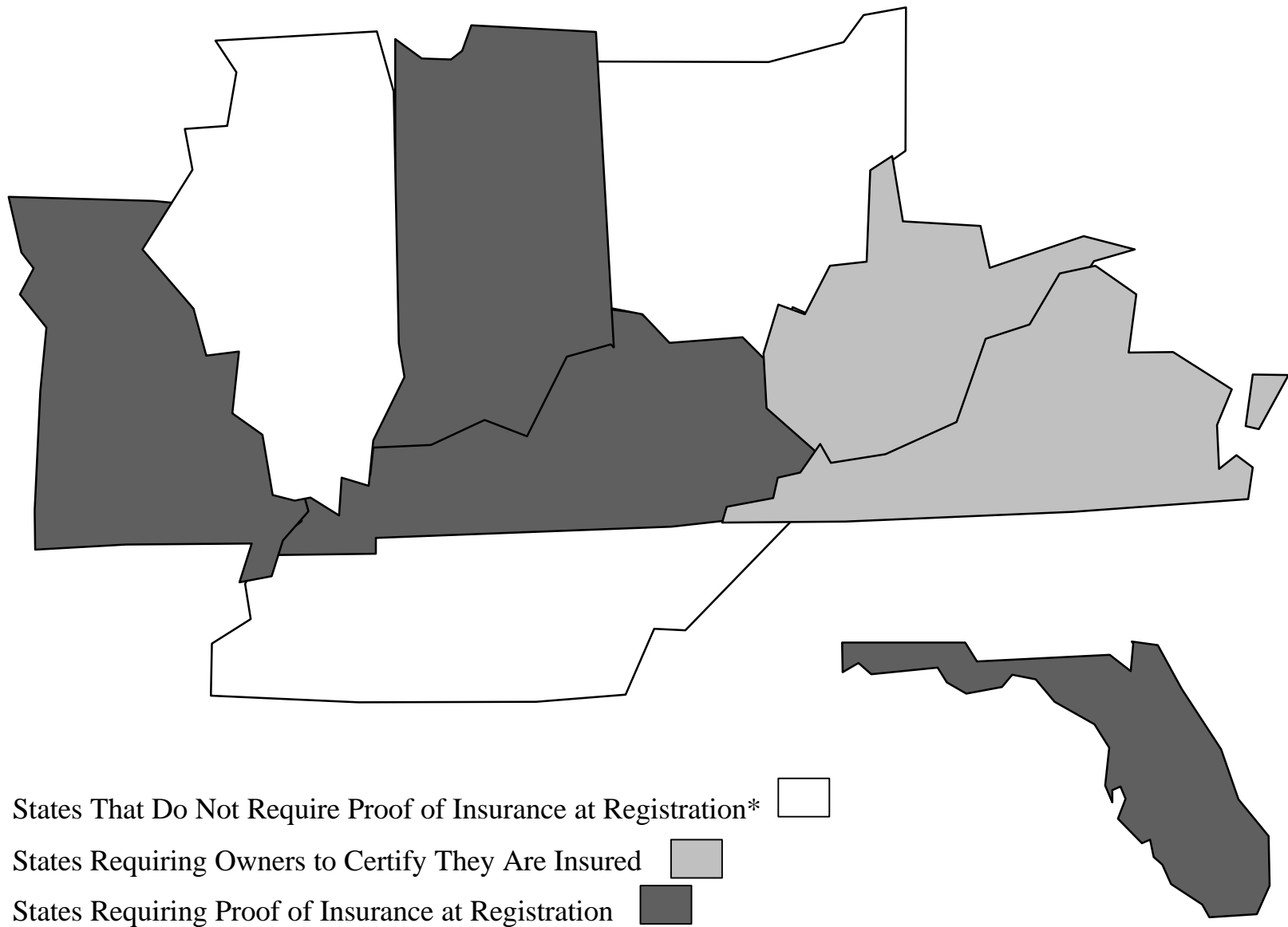
Motor Vehicle Fuel Tax Collections Per Capita



**Motor Fuel Tax Collection
Per Capita Basis FY 97**



State Motor Vehicle Insurance Requirements



*Ohio requires motorists to carry insurance, but does not require proof of insurance at registration.